

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
OPERATIONS SUMMARY
YEAR ENDED JUNE 30, 2000



CalPERS

REFLECTING CALIFORNIA'S TREASURES

PEOPLE - PRODUCTS - POTENTIAL



Profile

The California Public Employees' Retirement System (CalPERS) is the nation's largest public pension fund and the second largest in the world, with assets at June 30, 2000 of approximately \$172.5 billion.

Headquartered in Sacramento, CalPERS provides retirement and health benefit services to more than 1.2 million people and more than 2,400 public employers. The System also operates eight regional offices located in San Francisco, Glendale, Orange County, Sacramento, San Bernardino, San Diego, Mountain View, and Fresno.

CalPERS is led by a 13-member Board of Administration, consisting of member-elected, appointed, and ex officio members.

Our membership consists of 863,781 active and inactive members from the State, school districts, and local public agencies, and 355,690 retirees, beneficiaries, and survivors. Established by legislation in 1931, the System became operational in 1932 for State employees only. In 1939, public agencies were allowed to contract with CalPERS to provide retirement benefits for their employees. We began administering health benefits to State employees in 1962 under the Public Employees' Medical and Hospital Care Act. Local public agencies joined in our health program on a contract basis five years later.



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California

People - Products - Potential

They said it couldn't be done—span the Gateway to the Pacific. But just over four years after groundbreaking, the Golden Gate Bridge opened in May 1937. This modern wonder of the world stands as a landmark to all the possibilities California has to offer. CalPERS investments today play an important role in the fabric of the Golden State, with 9 percent of our \$172.5 billion portfolio dedicated to investments in California.

FINANCIAL HIGHLIGHTS

PUBLIC EMPLOYEES’ RETIREMENT FUND (UNAUDITED)¹ (Dollars in Thousands)

	2000	1999
Assets		
Cash & Cash Equivalents	\$9,848	\$7,265
Investments, at Fair Value	188,062,022	169,811,965
Receivables	3,004,709	2,228,945
Other Assets	80,733	74,749
Total Assets	\$191,157,312	\$172,122,924
Liabilities	\$18,616,768	\$12,765,139

Net Assets Held in Trust for Pension Benefits	\$172,540,544	\$159,357,785
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Additions & Deductions

	2000	1999
Additions		
Member Contributions	\$1,751,290	\$1,522,507
Employer Contributions	362,614	1,598,317
Net Investments Income	16,579,088	17,621,490
Other	3,570	1,036
Total Additions	\$18,696,562	\$20,743,350

Deductions		
Retirement, Death & Survivor Benefits	\$5,176,073	\$4,776,869
Refunds	140,644	160,841
Administrative Costs	175,051	145,814
Total Deductions	\$5,491,768	\$5,083,524

Increase in Net Assets Held in Trust for Pension Benefits	\$13,204,794	\$15,659,826
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Transfer to Supplemental Contributions Program Fund	(22,035)	—
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Change in Net Assets Held in Trust for Pension Benefits	\$13,182,759	\$15,659,826
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Complete financial information of all the Funds administered by CalPERS can be found in the Comprehensive Annual Financial Report for the year ended June 30, 2000.

NOTE:

¹ Differences in the amount shown for investment assets in these Financial Highlights and the Investment Portfolio amount reported in the Investments Section of this summary are due to differences in reporting methods. In accordance with GASB Statement No. 28, financial statements include Securities Lending Collateral. Also, Net Investment Receivables/Payables are not included here.



To Those We Serve

Customer service remains the primary focus at CalPERS. Our continuing improvements to our phone services, our business processes, and our efforts to protect the assets of the System will ensure that those who have dedicated their careers to serving California will receive the service and benefits they deserve.

PRESIDENT'S MESSAGE

Dear Friends:

On behalf of the 13 members of the CalPERS Board of Administration, I am pleased to present the CalPERS Operations Summary and Comprehensive Annual Financial Report for the 1999-00 fiscal year.



Dr. William Dale Crist
President

As we report on the milestones of our success this past year, we want to acknowledge our commitment to California. CalPERS has investments throughout the world, but the heart and soul of our Fund remains right here in California—and for this reason, we devote this report to California—its people, products, and potential.

We start with our own members, who have dedicated their careers to serving the people of California, and who contribute to their local communities, both during their work lives and into retirement. The assets that we hold in trust for them finance their retirements, largely through returns on our investments. We hope you enjoy reading about our many investments in the Golden State and recognize the important role the California economy plays in the continued growth of the CalPERS Fund.

Overall, we ended the 1999-00 fiscal year with continued strong asset growth, improved benefits for many members, and reduced contributions for many employers. We reengineered many of our business processes to simplify and improve customer service, and set the stage for further service improvements next year.

service improvements next year.

Here are a few highlights:

- Our assets increased by \$13.2 billion over the previous year, and we enjoyed the sixth straight year of double-digit returns on our investments.
- Our financial strength enabled us to reduce the annual contribution rates to zero for many employers. Our State and school members were offered improved benefit formulas, and CalPERS offered to provide local public agencies the ability to improve benefit formulas for their employees.
- We simplified our processes for obtaining service retirements, retirement estimates, and service credit purchases, and launched the Automated Communications Exchange System (ACES) that will allow employers to electronically send us their health and retirement payroll and employee enrollment information more easily in the future.

Over the next year, we will be expanding our capability to deliver better customer service, keeping our standards high and remaining competitive in a tough business environment. We will continue to be guided by the changing needs of our members and employers.

Respectfully submitted,



William Dale Crist, President
CalPERS Board of Administration

The Enduring Sea Point Reyes National Seashore

From the Miwok Indians who first inhabited this area, to today, California has become home to millions seeking to make a life from the State's fertile land, moderate climate, and receptiveness to innovation. California generates more goods and services than all the Western States combined. CalPERS invests in all aspects of our economy, including agriculture, industry, science, technology, home building, and real estate.

CaIPERS BOARD OF ADMINISTRATION



1. **William Dale Crist, President**; Employee Member (elected by State members); Professor, CSU Stanislaus; Term Ends: January 15, 2003. 2. **Robert F. Carlson, Vice President**; Retired Member (elected by retirees); Retired—Chief Counsel, Department of Transportation; Term Ends: January 15, 2004. 3. **Jennifer Ducray-Morrill, representative for Philip Angelides**, State Treasurer; Ex Officio Member. 4. **Willie L. Brown, Jr.**, Elected Official of Local Government ¹; Mayor of San Francisco; Term Ends: January 15, 2004. 5. **Kathleen Connell**, State Controller; Ex Officio Member. 6. **Rob Feckner**, Employee Member (elected by school members); Glazing Specialist; Napa Valley Unified School District; Term Ends: January 15, 2003. 7. **Michael Flaherman**, Employee Member (elected by public agency members); Economist, Bay Area Rapid Transit; Term Ends: January 15, 2003.

NOTES:

¹ Governor appointee.

² Appointed jointly by the Speaker of the Assembly and the Senate Rules Committee.

8. **Sean Harrigan**, State Personnel Board Member (designated by the State Personnel Board); Term Ends: Serves at the pleasure of the State Personnel Board. 9. **Marty Morgenstern**, Director, Department of Personnel Administration; Ex Officio Member. 10. **Mike Quevedo, Jr.**, Public Representative ²; Term Ends: January 15, 2004. 11. **William Rosenberg**, Employee Member (elected by all members); Retired—Retirement Specialist, CalPERS; Term Ends: January 15, 2002. 12. **Joseph A. Thomas**, Official of Life Insurer ¹; Board of Directors, Best Life Assurance Company; Term Ends: January 15, 2001. 13. **Charles P. Valdes**, Employee Member (elected by all members); Counsel, Department of Transportation; Term Ends: January 15, 2002.



CalPERS BOARD COMMITTEES

In addition to their regular duties, Board Members also serve on permanent and ad hoc committees to review specific programs, projects, or issues and make recommendations to the Board. The following committees were active as of June 30, 2000.

Benefits & Program

Administration

Rob Feckner, Chair
William Rosenberg, Vice Chair
Robert F. Carlson
Kathleen Connell
William D. Crist
Michael Flaherman
Sean Harrigan
Marty Morgenstern

This committee reviews all matters related to benefit program structure, actuarial studies and rate setting, retirement program policy, and administrative issues.

Health Benefits

Philip Angelides, Chair
Rob Feckner, Vice Chair
Kathleen Connell
Sean Harrigan
Marty Morgenstern
William Rosenberg
Joseph A. Thomas
Charles P. Valdes

This committee oversees the administration of the Public Employees' Medical & Hospital Care Act program and the Public Employees' Long-Term Care Act program.

Finance

Robert F. Carlson, Chair
Kathleen Connell, Vice Chair
Philip Angelides
William D. Crist
Michael Flaherman
William Rosenberg
Charles P. Valdes

This committee provides financial oversight on all budget matters, evaluates funding alternatives, oversees preparation and recommends approval of the CalPERS budget, and oversees the CalPERS annual and periodic audits by both internal and external audit units.

Performance & Compensation

Joseph A. Thomas, Chair
Robert F. Carlson, Vice Chair
William D. Crist
Rob Feckner
Mike Quevedo, Jr.
Charles P. Valdes

This committee studies and evaluates compensation mechanisms and criteria, develops policies and procedures, and makes recommendations to the Board concerning compensation of key personnel.

Strategic Planning

William Rosenberg, Chair
Michael Flaherman, Vice Chair
Philip Angelides
Kathleen Connell
Rob Feckner
Joseph A. Thomas

This committee oversees the strategic planning process, including selection of consultants, defining process direction, and monitoring implementation of the CalPERS Strategic Plan.

“Tierra del Fuego” Land of Fire

This phrase was coined by Spanish explorers when they discovered vast expanses of fire-orange poppies. Named the California State Flower in 1903, the Golden Poppy continues as a symbol of the bounty of the State’s lands.



Investment

Michael Flaherman, Chair
Sean Harrigan, Vice Chair
Philip Angelides
Willie L. Brown, Jr.
Robert F. Carlson
Kathleen Connell
William D. Crist
Rob Feckner
Marty Morgenstern
Mike Quevedo, Jr.
William Rosenberg
Joseph A. Thomas
Charles P. Valdes

This committee reviews investment transactions, the investment performance of both internal and external managers, and establishes investment policy and strategy.

Investment Policy Subcommittee

Charles P. Valdes, Chair
Philip Angelides
Robert F. Carlson

This subcommittee conducts an inventory of all existing investment policies, procedures, and guidelines for review by the Investment Committee and reviews and recommends revisions to these on a priority basis. It is also charged with developing a manual of policies, procedures, and guidelines, and a process for periodic revisions.

R Street Subcommittee

Charles P. Valdes, Chair
Robert F. Carlson, Vice Chair
William D. Crist
Rob Feckner
Michael Flaherman

This subcommittee oversees the CalPERS headquarters expansion project, including the selection of contractors, approval of building designs, and approval of expenditures and budgets.



Preserving the Past Yosemite National Park

John Muir’s struggle to preserve Yosemite’s Giant Sequoias, glacier-formed valleys, and pristine waterfalls led to the creation of this national park in 1890, which receives roughly 4 million visitors a year. At CalPERS, our foremost responsibility is to educate and serve our members, and we lead the effort for continuous, constructive change.

CaIPERS STAFF

**Executive Staff**

1. **James E. Burton**, Chief Executive Officer. 2. **James H. Gomez**, Deputy Executive Officer.
 3. **Robert Aguallo**, Assistant Executive Officer, Investment Office. 4. **Vincent P. Brown**, Assistant Executive Officer, Financial & Administrative Services. 5. **Allen D. Feezor**, Assistant Executive Officer, Health Benefit Services. 6. **Kayla J. Gillan**, General Counsel. 7. **Barbara Hegdal**, Assistant Executive Officer, Member & Benefit Services. 8. **Patricia K. Macht**, Chief, Office of Public Affairs.
 9. **Daniel Szente**, Chief Investment Officer, Investment Office [Sheryl Pressler, Chief Investment Officer through February 2000]. 10. **Ron Seeling**, Chief Actuary, Actuarial & Employer Services. 11. **Robert D. Walton**, Assistant Executive Officer, Governmental Affairs, Planning & Research.

Divisions

Denise Arend
Manager, Investment Operations

Tom Britting
Chief, Office of Audit Services

Jack Corrie
Chief, Information
Technology Services

Tom Fischer
Chief, Self-Funded Programs

Tim Garza
Chief, Management
Information Systems

Pat Harris
Chief, Branch Development
Center

Mitzi Higashidani
Project Director, COMET

Linda Hoff
Chief, Office of Policy &
Program Development

Charles Hwu
Administrator, Data
Administration

Gary M. Jones
Chief, Member Services

Michael W. Koester
Chief, Operations Support
Services

John Korach
Chief, Fiscal Services

Ron Kraft
Project Leader, Customer
Service Project

Jeff Lung
Information Security Officer,
Office of Information Security

Linda McAtee
Deputy General Counsel,
Legal Office

Ken Marzion
Chief, Actuarial & Employer
Services

Dave Mullins
Chief, Supplemental Savings
Program

Chris Nishioka
Chief, Benefit Services

Michael Ogata
Chief, Planning & Research

Tom Pettey
Chief, Human Resources

Steve Phillips
Chief, Change Management

Diana Proctor
Chief, Headquarters Expansion
Project

Fred Steinmetz
Chief, Health Benefit Services

Janet Toney
Project Manager, COMET
Phase IV

Nancy Welsh
Chief, Health Program
Development

Casey Young
Chief, Office of Governmental
Affairs

Regional Offices

Vacant
Manager, San Bernardino

Anita Commer
Manager, San Francisco

Laura Duran
Manager, Orange County

Elaine Edwards
Manager, San Diego

Debra Gibson
Manager, Sacramento

Edith Mercer
Manager, Glendale

Elwin Nash
Manager, Mountain View

Steve Pietrowski
Manager, Fresno



One Home at a Time

California continues to realize expansive growth as the place of choice to live. As one of California's largest real estate developers, we help make it possible for many to realize the dream of home ownership—financing more than \$2 billion worth of single family homes and general real estate holdings. Since inception, our Member Home Loan Program has provided more than \$7 billion in mortgages to nearly 54,000 California families.

THE YEAR IN REVIEW

Retirement Benefits Enhanced

On January 1, 2000, more than 500,000 CalPERS State and school members realized the most extensive retirement benefit enhancements in more than 30 years, when Senate Bill 400 took effect. S.B. 400 required a *massive* implementation effort that impacted literally every area in CalPERS. In a three-month period, all CalPERS computer systems were programmed, employer codes were changed, and processes were put in place to administer the new benefits to our members. Numerous member fact sheets were prepared, and 24 member benefit booklets were revised and reprinted. The CalPERS

On-Line Retirement Calculator was also revised to incorporate the enhanced formulas.

In addition to eliminating the requirement that newly hired State Miscellaneous and State Industrial members be placed in State Second Tier membership, S.B. 400 provided existing State Second Tier members the opportunity to move to First Tier membership. Nearly 30,000 members elected to make this change for the *future*. Of this number more than 20,000 also elected to convert *past* Second Tier service to First Tier. S.B. 400 also changed the final compensation period for school members from 36 months to 12 months and extended the 5th level 1959 Survivor Benefit to school employees and to a larger group of State employees. State and school retirees received an ad hoc cost-of-living increase of between 1 percent and 6 percent, depending on their year of retirement.



Umoja, House of Unity Los Angeles

Our \$2 million investment in the AFL-CIO Housing Investment Trust helped ensure affordable housing was available to those once homeless. The “Umoja, House of Unity,” is a Los Angeles apartment complex where residents participate in training programs to learn job, parenting, money management, and other skills.

RETIREMENT PROGRAM HIGHLIGHTS FOR THE YEAR

- 863,781 active and inactive members
- 355,690 retirees, beneficiaries, and survivors
- 18,443 new retirees
- \$5.2 billion paid in benefits
- 2,465 public agency employers (including school districts)

Many State and school members postponed their retirements until 2000 in order to receive the enhanced benefits. As of June 30, we had processed 23,279 applications for retirement, welcomed 18,443 new retirees to our benefit roll, and paid out \$5.2 billion in benefits, an increase of 8.3 percent over the previous year.

Serving Our Members

CalPERS launched our Service Level Improvement Project (SLIP) in 1999 as part of an ongoing effort to enhance key customer services, reduce business process turnaround time, and eliminate redundant procedures. Three areas were identified where services could be improved: retirement application processing, retirement estimate development, and service credit purchasing. Processes were then studied and reengineered to better administer these vital services. Once the new processes were in place, CalPERS staff conducted 34 statewide training seminars to educate employers.

As part of these reengineered processes, several booklets were developed to serve as a “one-stop-shop” for members. The booklets contain all necessary instructions and forms to complete an application for a service or disability retirement, and to purchase service credit.

Four new process areas have been targeted for service level improvement efforts during fiscal year 2000-01: retirement adjustments, service credit receivables, post- and pre-retirement death benefit processing, and public agency health billing.

Another effort to improve service to our members occurred in October 1999, when we consolidated the two Telephone Information Centers formerly operated separately by our Member Services and Benefit Services Divisions into a new Branch Telephone Information Center. The merger required a complete redesign of telephone systems and software applications, a review and updating of processes and procedures, development of a new organizational reporting structure, cross-divisional training, and the relocation of 45 staff members. During the year, nearly 1 million customer telephone calls were fielded by both the new Branch Telephone Information Center and the Health Benefit Services Telephone Information Center.

The on-line Retirement Planning Calculator on the CalPERS web site continues to be extremely popular with members. This financial planning tool estimates monthly retirement allowances and survivor benefits based on salary, retirement date, and other information keyed in by the member. It also allows the member to *immediately* see the effect of a change in a chosen retirement date or option.

As part of our member education program, staff conducted 354 full-day Financial Planning Seminars, serving a total of 14,025 active members and their spouses. These seminars provide an overview of CalPERS benefits and programs and stress the importance of participation in tax deferral plans for additional retirement income. They also offer information on financial planning, investment strategies, savings, insurance, personal budgeting, and estate planning. In addition, Financial Planning Seminars for *retirees*, which premiered last fiscal year, proved to be as popular as those for active members. Ninety-nine seminars were held for 6,935 retirees across the State. An additional 54,000 members enrolled in Retirement Planning Workshops or employer-sponsored retirement sessions, and a new seminar for judges developed during the year was presented seven times, before a total audience of 400.



Communication

In May 2000, CalPERS launched our first “Retirement Planning Month” campaign, generating a favorable response from our members. CalPERS partnered with the American Savings Education Council to raise CalPERS member awareness of the need to take stock of their retirement resources. A special issue of the *PERSpective* newsletter, a new retirement planning kit (one for active members and a separate one for retirees that focused on continued financial planning after retirement), and a web-enabled

“BallPark Estimate” worksheet captured the attention of members. By the end of the fiscal year, more than 6,500 retirement planning kits had been mailed out, and 58,626 members had visited the special retirement section on the CalPERS web site. In addition, almost 800 members showed up on the steps of the State Capitol in Sacramento on May 23, 2000 for a special “Team Up With CalPERS” day, featuring retirement planning and the Member Home Loan Program.

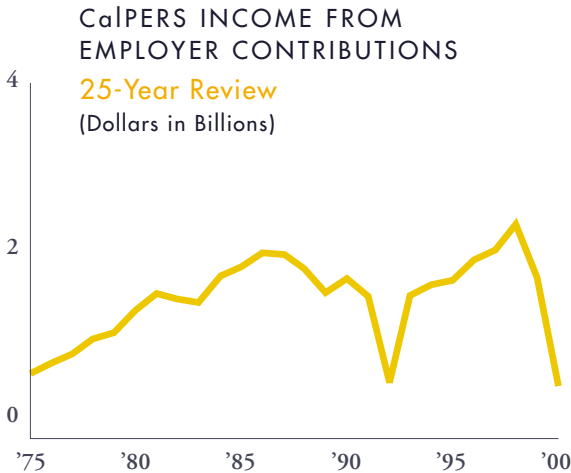
During fiscal year 1999-00, CalPERS staff produced seven member education videos. This included single subject videos such as “CalPERS Health Benefits Program,” as well as the CalPERS Member Network (CMN) videos, full-scale productions targeted to members, employers, employee organizations, and CalPERS staff. CMN topics included “Benefit Equity,” “Retirement Planning Month,” and “CalPERS Customer Service Improvement Project.” These popular videos are distributed in a variety of ways, through member association representatives, local access cable television stations, and employers. They are also shown to members who visit our Regional Offices.

After receiving feedback from active members about difficulties in receiving the quarterly *PERSpective* newsletter on a regular basis, CalPERS changed distribution methods in Fall of 1999. Since that time, *PERSpective* has been mailed directly to members’ homes, rather than being distributed at the workplace. Member reaction has been positive, according to a

telephone survey conducted in May 2000. The survey showed that 89 percent of members now regularly receive *PERSpective*, 49 percent always read it, and 92 percent want CalPERS to continue to publish it.

Headquarters Expansion Project

CalPERS, which currently houses staff in three *separate* office locations, began a headquarters expansion project during the year. The new complex will cover four square blocks adjacent to the current Lincoln Plaza building. It will include 550,000 square feet of office space for CalPERS staff, as well as space for small businesses, parking, and residential use. Determined to be a good neighbor, CalPERS has involved the local community in the project from the outset, holding six community workshops and making presentations to local government agencies, including the Sacramento City Council. The master plan and schematic design will incorporate numerous community suggestions. The project is expected to be completed in 2004. CalPERS has received praise from local neighborhood groups and government officials for its “community-friendly” approach.



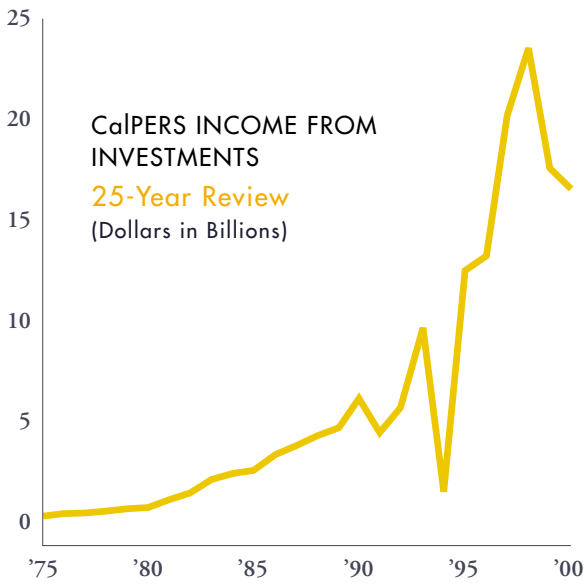
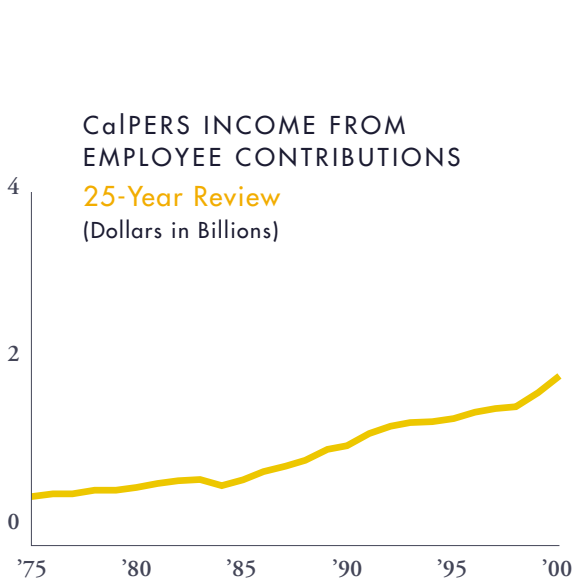
Improving Service to Employers

Employer contribution rates again decreased in the fiscal year as a result of excellent CalPERS investment returns, low inflation, and prospects for long-term wage growth. In fiscal year 1999-00, more than 2,010 contract amendment valuations were completed, 472 benefit changes were made, and 345 contract amendments were completed. Some 27 new agencies contracted with CalPERS. In addition, approximately 36,000 payroll reports were processed. The Actuarial and Employer Services Division’s team representatives trained 550 employers in membership, payroll, and health benefits procedures, an increase of 47 percent over last year. In addition, special education sessions were scheduled with key staff in various State agencies to inform them of the provisions and impact of S.B. 400.

An updated version of the CalPERS Payroll Reporting System was made available to all employers on the CalPERS On-Line web site. This software program allows employers to enter payroll information on a personal computer and submit the information to CalPERS on diskette. Customers can download the software from the web or order it on CD or diskette.

As part of the *employer-focused* element of the Service Level Improvement Project, we examined our contract amendment cost valuations to see if this work could be expedited. Processes were subsequently reengineered, resulting in a decrease in the average processing time for these valuations from 102 to 28 calendar days. In November 1999, the CalPERS Board adopted an actuarial assumption change from 90 percent to 95 percent of market value for many rates in the midst of production. Nevertheless, all of the public agency rates for fiscal year 2000-01 were mailed to employers by December 1999. The State and school rates were also produced on time. This was the earliest these rates had been produced in many years.

The education of employers regarding reportable compensation continued as a customer service priority during the year, and staff responded to nearly 16,000 employer telephone inquiries on this topic. In addition, nearly 1,000 employers were assisted in processing their CalPERS resolutions for Employer Paid and Tax Deferred Member Contributions contract amendments.



Work continues toward full implementation of our new corporate database, COMET (CalPERS On-line Member and Employer Transaction system). Those portions of COMET in operation during the fiscal year enabled staff to complete 457,006 public agency transactions and 134,793 State transactions of various types, including enrollments, benefit coverage changes, reclassifications, status changes, and name and address changes.

Planning began late in the fiscal year for the first-ever CalPERS employer conference, which was held on October 30, 2000 in Anaheim. The conference was designed to help employers gain an understanding of the CalPERS direction and goals for the 21st century, as well as to provide them the opportunity to share their concerns.

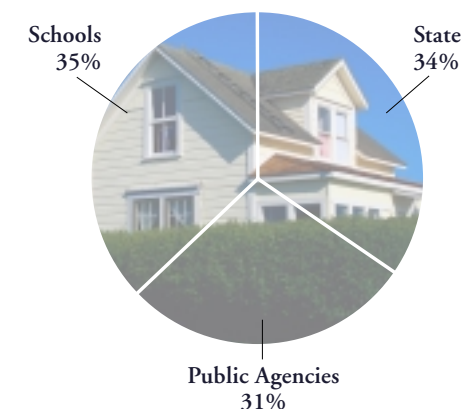
In addition, in the latter part of the fiscal year, plans were finalized for the “proof of concept phase” of the Automated Communications Exchange System (ACES), to be held during the first quarter of fiscal year 2000-01. ACES was designed to allow employers to electronically transfer retirement and payroll files through a secure Internet connection with CalPERS or make employee retirement and health enrollment changes on-line. More than a dozen agencies, including State, public agency, and school employers, were scheduled to participate in this phase, with the ACES team providing training, soliciting feedback on system usability, and making necessary application changes before expanding ACES to additional employers in the 2001-02 fiscal year.

Organizational Effectiveness

In fiscal year 1999-00, we revisited our Strategic Plan to better guide CalPERS in becoming a more effective organization. The revised Plan focuses on our three primary goals—to better serve our customers, to expedite benefit delivery, and to improve the management of our assets. Guided by this Plan, we have begun making computer systems and procedures more efficient to enable our staff to respond more quickly to customer inquiries.

CalPERS has always used evolving technology to achieve our business objectives and to meet growing customer service demands. In the 1990s, we began replacing our mainframe computers with client server systems, allowing for greater flexibility and program growth. At the same time, the possible impact of Year 2000 issues became the overriding concern of every business and government agency in the world. To assess our Y2K readiness, we evaluated *each* business application to determine if it should be retired, remediated, or replaced. Many of our PC applications were retired. Other systems were remediated to extend their use until 2010, and remaining systems were slated for replacement. This project was officially completed in February 2000 after both the January 1st rollover weekend and February 29th passed uneventfully.

MEMBERSHIP BY EMPLOYER



Members who want to know the possible cost of purchasing service credit can now use the “Service Credit Cost Estimator” tool, which was launched on the CalPERS web site at the end of the fiscal year. The Estimator operates like the Retirement Planning Calculator and lets members get an estimate of the cost to purchase several kinds of service credit.

Recognizing that our “people” assets are the driving force behind our continued success as an organization, we continued to focus during the year on the recruitment and retention of a quality workforce. We recruited and filled 245 positions, including highly sought-after actuarial staff, 15 key investment management positions, and a large number of information technology professionals. Thirty-eight examinations were administered to 1,600 applicants. To assist our employees with work-life balance, we also established a model telework program as an alternate work option. Our program is currently being used by the Department of Personnel Administration as an example of innovation in work scheduling.

A comprehensive training plan was begun during the year, featuring an expanded New Employee Orientation Program that explains our business direction and values to newly hired staff members. Also new during the year was an Intranet-based version of the Employee Development Resource Guide that provides staff a comprehensive on-line listing of the skills and knowledge needed for various positions at CalPERS, and a leadership training platform that provides five levels of training—from Leadership Basics to Advanced Management.

CalPERS and individual staff members received more than 15 industry awards for various

accomplishments, including a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association for the 1998-99 *Comprehensive Annual Financial Report* and a rare “fully complies” opinion from the Department of Finance regarding compliance with the Institute of Internal Auditors’ *Standards for the Professional Practice of Internal Auditing*. CalPERS also received the National Association of Employee Recognition’s “Recognition Champions” Award as a “best practice” organization for our approach to employee recognition. Our Office of Public Affairs received communication industry awards for the *MakingCents* and *PERSpective* newsletters, the *CalPERS Comprehensive Annual Financial Report*, and two videos, “CalPERS for Life” and “Helping You Achieve Your Dreams for the Future,” which explains the CalPERS Public Agency 457 Deferred Compensation Program.



Los Esteros Apartments
San Jose

Our investment in the AFL-CIO Housing Investment Trust helped build Los Esteros, bringing affordable housing to the inner city.

In addition, CalPERS staff broke records on “giving back” to the community—donating 41,000 pounds of food during the Holiday Food Drive; donating 291 units of blood; and supporting the Susan B. Komen Breast Cancer Fund, the American Cancer Society, the March of Dimes, and the United California State Employees Campaign. Staff donations to these various charities exceeded \$125,000.



Real Estate Listing PropertyFirst.com

In November 1999, we made a \$1.4 million investment in PropertyFirst.com, an on-line real estate listing service for commercial and consumer real estate that allows investors to view property listings and prospective tenants to look for available space.

Supplemental Savings Programs

Public Agency 457 Deferred Compensation

The CalPERS Public Agency 457 Deferred Compensation Program had another successful year, experiencing a 48 percent increase in assets and a more than 41 percent increase in participants (adding 2,129). The Program also added 84 public agencies to our roster. To achieve better investment performance for members, CalPERS adjusted the core fund lineup, adding the Russell 2000 Equity Index Fund. We also restructured the asset allocation funds to track domestic and international bond and equity indexes.

CalPERS also revised the rules for participating in the Self-Managed Accounts (SMA), enabling members of those agencies offering the SMA option the ability to move money between core funds and the SMA with a minimum balance of \$1,000 held in the core funds. In addition, the Deferred Compensation Program placed more representatives in the field to consult with members personally about their retirement needs. A new web site was introduced with expanded retirement education features and live account transaction capability that enables members to manage their deferred accounts over the Internet.

State Peace Officers' and Firefighters' Defined Contribution

In fiscal year 1999-00, the State Peace Officers' and Firefighters' Defined Contribution Plan was made available to supervisors and managers in those membership categories. The Plan provides an employer-paid retirement benefit to supplement the benefits they will receive through their regular CalPERS retirement.

Other Programs

We also modified the Supplemental Contributions Program to operate as an independent defined contribution plan to which eligible members may voluntarily elect to contribute. The Replacement Benefits Program was also designed, developed, and implemented to pay replacement benefits to the small percentage of retired members whose retirement benefits payable under their CalPERS retirement plan were limited by Internal Revenue Code Section 415(b).

Member Home Loan Program

The CalPERS Member Home Loan Program offers real estate financing to active, inactive, and retired members. The program offers competitive rates, a free 60-day interest rate lock, controlled closing costs, and a 100 percent financing option (a combination of a mortgage loan and a personal loan secured against the member's contributions). It is administered by more than 70 lending institutions with nearly 800 branch locations throughout the State and is also available nationwide. Information about the CalPERS Home Loan Program is available on our web site and is provided to members at numerous buyer education events throughout the year.



In fiscal year 1999-00, more than 7,600 loans were issued, valued at approximately \$1.2 billion, including more than 200 loans issued to members who live outside the State of California. More than 2,800 personal loans were issued, valued at approximately \$21 million.

During the year, loan limits were increased from \$350,000 to more than \$1 million, to allow CalPERS members living in higher cost areas to benefit from the Program. In addition, the Personal Loan Program was made more flexible and can now be used in combination with the home loan and secondary financing. A Premium Pricing Program was introduced that allows members to pay a slightly higher interest rate and receive funds back to cover their closing costs. CalPERS members may also be eligible for lower mortgage insurance rates and reduced escrow and title fees.

Investing in the Future California Biotechnology Fund

The State's burgeoning biotechnology industry has the potential for untold advances in medicine, medical techniques, and food production. Understanding the impact to the future of Californians and those around the world, CalPERS has dedicated a \$500 million investment to our California Biotechnology Fund. The future begins today, and CalPERS is helping in the quest to realize the full potential of what science can bring to our lives.

HEALTH AND LONG-TERM CARE REPORT

CalPERS Health Program

The 1999-00 fiscal year was a pivotal one for CalPERS and managed care in general—both in terms of strategic planning and policy options. We faced some of the most daunting challenges in our 38-year history as a health purchaser, requiring innovation, imagination, and leadership from CalPERS to a degree undreamed of a decade ago. There were widespread warnings that without sweeping reforms, the basic concept of health maintenance organizations (HMOs) might not survive the decade.



Preserving Good Health

CalPERS has more than \$140 million invested in companies that develop medical equipment and products to maintain good health. Preserving and improving the health quality of our lives is the focus of our Health Program, and our investments in this area help lead the way.

The year found the American health care industry in considerable turmoil, with near double-digit premium hikes, continued HMO pullouts from rural counties and from Managed Medicare, many doctor groups and hospitals in financial distress, prescription costs soaring 15 to 20 percent per year, and the backlash against managed care still reverberating.

A decade ago, when health care inflation was threatening to devastate the U.S. economy, CalPERS helped bring a temporary return to rate stability by pioneering the transition to managed care. Many leaders were once again looking for fresh ideas and new solutions from CalPERS, the nation's second largest public purchaser of employee health care behind the federal government.

HEALTH PROGRAM HIGHLIGHTS FOR THE YEAR

- 1,140,984 employees, retirees, and family member participants
- 61 percent are State members
- 39 percent are public agency and school members
- 1,341 participating public agencies
- \$1.8 billion paid in annual health premiums
- 130,000 enrollment documents processed during open enrollment
- More than 30,000 Open Enrollment transactions

In response to the growing health care crisis, CalPERS initiated a major feasibility study on adding “direct contracting” to the existing health care options available to our members. Contracting directly with certain doctor groups and hospitals rather than working through HMOs would give CalPERS more control over the quality and price of medical care. This would not be a total replacement for our existing HMOs, but an *additional option* for our members.

TOTAL HEALTH PROGRAM MEMBERSHIP
Five-Year Review



During the year CalPERS also began a major study to determine whether members of the California State Teachers' Retirement System (CalSTRS) should be given access to CalPERS health coverage. CalSTRS currently does not offer a health program, and many of California's retired teachers have inadequate or expensive health coverage (or none at all) from their individual school districts.

Managing Member Health Care Costs

CalPERS also completed difficult and protracted premium rate negotiations during the year. Amid widespread predictions that nationwide rates for 2001 might increase by 10 to 13 percent, we succeeded in holding the average increase for our 10 Basic HMOs significantly below those figures at 9.2 percent—half a percent lower than our previous year's increase.

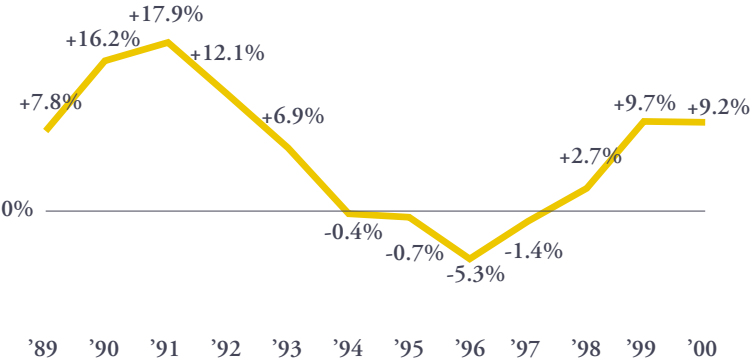
The biggest single cause of the increase was the skyrocketing cost of prescription drugs—accounting for nearly 30 percent of the premium increase for our Basic HMOs and roughly 50 percent for our Medicare-coordinated plans. One factor is direct-to-consumer drug advertising, which encourages patients to demand the most expensive new brand name drugs when less expensive drugs are often as effective. There is also the increasing use of newly developed, expensive drugs to replace other forms of treatment.

CalPERS spent much of the year researching the possible use of higher copayments for brand name prescription drugs and office visits as a way to moderate premium increases and to encourage the voluntary use of generic and mail-order drugs. (Copayments for the 10 HMOs are still frozen at 1993 levels, even though medical costs have increased 120 percent since 1993.) However, the Board decided to delay any copay increase to give constituent groups more time to study the effect on members.

Customer Service

During the year we made major progress in providing improved customer service to our members. To moderate the effect of network disruptions—HMOs and medical providers canceling their contracts as a negotiating tactic—CalPERS added a new, searchable physician directory to our web site. This directory enables members to locate a physician by health plan, specialty, geographical area, office hours, hospital affiliation, medical training, years of practice, board certification, gender, and license status. It also allows members to rate individual physicians in terms of customer service. The physician directory was also expected to be a major help to members when changing health plans during Open Enrollment periods.

HISTORY OF BASIC HMO
PREMIUM AVERAGES
Percent Decrease
or Increase.
Based on Weighted Average
of all CalPERS HMOs



As part of the Automated Communications Exchange System, the “ANSI 834 EDI” enrollment system was also rolled out to 10 of our health plans, covering 90 percent of our members. This system greatly enhances communication between CalPERS and the plans and speeds up issuing of health plan ID cards.

The 1999 Open Enrollment period was the second largest in our history. Thanks to a major team effort, we successfully processed more than 30,000 plan changes and new enrollments. During the entire year, 130,000 enrollments were processed—an average of 385 per day.

CalPERS continued our national leadership in monitoring and improving health plan quality and customer satisfaction. Our Health Plan Quality Report for the year 2000 rates each of our HMOs and two self-funded preferred provider organizations in terms of patient satisfaction, access, and health care factors.

New Members

The CalPERS Health Program continued rapid growth during the fiscal year. More than 66,000 new members were added, bringing total membership to 1.14 million active and retired public employees and their family members. The growth rate of public agency enrollments was more than double that of recent years. Ninety-seven new public agencies with more than 52,000 new members joined during the year. Public agencies now constitute 39 percent of our membership.

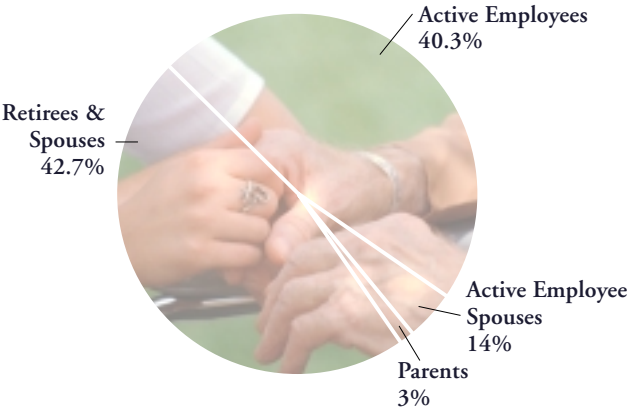
The CalPERS Long-Term Care Program

It was a banner year for the CalPERS Long-Term Care Program, which continued its rapid growth and added improved benefits to the existing plans—with no increase in premiums. During 1999-00, membership grew to nearly 131,000. Only 7,278 members have voluntarily terminated since the inception of the Program. This maintains our position as one of the top 10 long-term care programs in the nation and is a strong endorsement of our Program’s excellent value.

The trend continues for long-term care purchase by older active employees and younger retirees. Active employees and their spouses have been more involved in recent application periods and represent an estimated 68 percent of new members in the year 2000, compared to only slightly over 50 percent in previous years. The majority of members are continuing to purchase the most comprehensive and higher priced coverage options.

By the end of the year, annual premium income had grown to approximately \$152 million. The average annual premium is \$1,210, down slightly

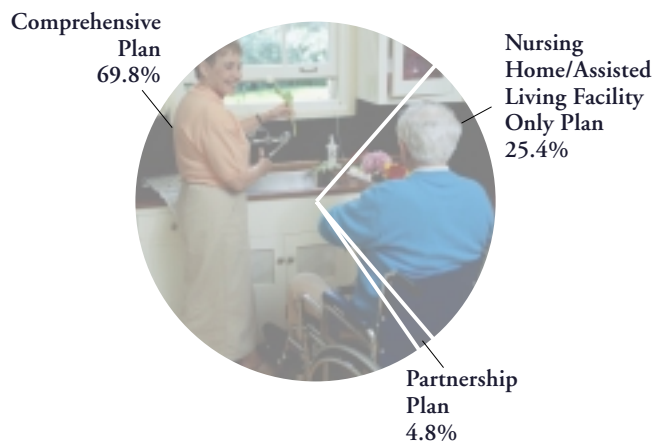
TOTAL LONG-TERM CARE PROGRAM MEMBERSHIP



from last year's average of \$1,218. This is due primarily to a shift toward more new enrollment from active employees and their spouses, plus the introduction of a \$100 maximum daily benefit for all plans. During fiscal year 1999-00, the Program paid \$11 million in claims, while reducing our administrative costs as a percent of revenue for the fifth straight year in a row. Since the Program's inception in 1995, \$21.7 million has been paid in claims. As of June 30, 2000, the Program had accumulated \$550 million in assets (at market value). The current surplus of \$16.6 million is \$51.7 million less than at the end of the prior fiscal year, primarily because of a one-time charge to surplus of \$36.2 million for benefit enhancements approved by the CalPERS Board.

When the Program started, CalPERS deliberately took a very conservative approach to funding to be certain the money for claims would be available when needed. This year, we reached the point that benefits could be improved at no additional cost, using accumulated reserves that resulted primarily from lower-than-expected claims and better-than-expected investment returns.

LONG-TERM CARE MEMBERSHIP BY PLAN TYPE



LONG-TERM CARE PROGRAM HIGHLIGHTS FOR THE YEAR

- 131,000 participants
- Average annual premium is \$1,210
- \$152 million annual premium income
- \$11 million paid in claims

Major benefit improvements were added for both new and current members. Deductible periods were shortened from 90 "service days" to 90 "calendar days" for the Comprehensive and Nursing Home/Assisted Living Facility Only plans, and from 30 "service days" to 30 "calendar days" for the Partnership Plan. (A service day is a day on which a service is actually provided. This improvement significantly shortens the time required to meet the deductible for members receiving services only a few days each week.) In addition, all plans added a hospice benefit, covering services for the terminally ill that are not covered by regular health plans or by Medicare.

CalPERS also launched new plan options offering reduced premiums in return for slightly reduced benefits. These options are designed for those who prefer a lower level of protection—either because they have enough savings to pay for some of their own long-term care needs or because they cannot afford full coverage.



Washington Building
Los Angeles

CalPERS helped finance the renovation of the historic Washington Building. When completed, this 91-year-old building will house hundreds of employees from several State agencies. CalPERS remains committed to preserving the Trust Fund for our members through sound, diversified investments.

INVESTMENTS

A Long-Term Vision in a Volatile Market

The CalPERS investment portfolio grew by approximately \$13 billion, ending the 1999-00

fiscal year at \$172.5 billion.

We earned a 10.5 percent return on investments, marking the sixth straight year of double-digit returns. Over the five-year period ended June 30, 2000, we earned a 15.6 percent return, better than most multi-billion dollar public pension funds, according to data compiled by the Trust Universe Comparison Service (TUCS).



Bringing Life Back to Inner Cities Hollywest Shopping Center, Hollywood

In 1996, CalPERS teamed with real estate advisor Victor B. MacFarlane to form California Urban Investment Partners. This group is dedicated to preserving and restoring daily life to our inner cities through development of quality retail properties in predominantly minority, urban California neighborhoods.

This performance was a culmination of superior investment and risk management and was well above the 8.25 percent assumed actuarial rate of return needed to pay retirement benefits. At the same time, we recognize that the investment climate over the last five years has been one of the most favorable in history. Since the markets will someday *underperform* expectations, our excess returns will better enable us to weather these lean years.

Our investment performance was led by strong gains in our equity investments. Our alternative investment and private equity portfolios returned 57.8 percent, beating our 15 percent benchmark. International stocks returned 20.1 percent, compared to a benchmark return of 17.6 percent. Despite volatility in the market, our U.S. stock investments returned 8.3 percent, matching the benchmark return of the Wilshire 2500.

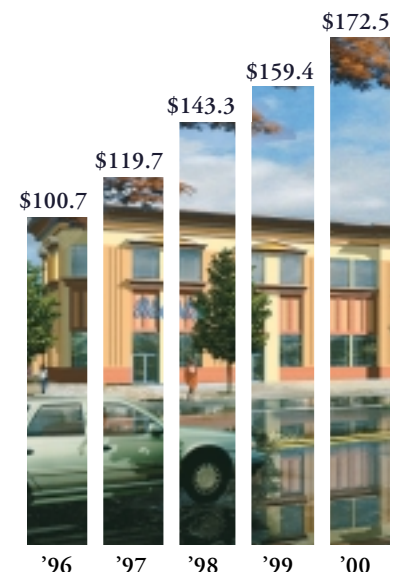
Our U.S. bonds gained 3.8 percent, while our international bonds fell slightly, earning a negative 0.9 percent. Our real estate investments earned a 13.2 percent return for the one-year period.

At the end of the year, we held approximately \$110.9 billion in U.S. and international stocks, \$45.2 billion in U.S. and international bonds, \$9.2 billion in real estate, and \$7.2 billion in privately held investments.

Investment Policy and Strategy

The CalPERS Board has investment authority and sole responsibility for the management of assets. The Board decides how the assets are allocated and makes the investment decisions that staff implement on a daily basis. Every month, the Board receives reports on performance, transactions, manager reviews, cash flow estimates, activity deal flow, and partnership and manager selections in order to monitor asset classes. Once a year the Board participates in an asset liability management workshop to review the asset class targets and also meets in a special workshop to analyze factors important in determining the appropriate asset

GROWTH OF INVESTMENT
PORTFOLIO — MARKET VALUE
Five-Year Review
(Dollars in Billions)



allocation. The health of the global financial markets, future liabilities of the System, and expected future contributions are also analyzed.

In May 2000, the Board adopted a new asset allocation policy. Asset allocation is one of the most important policies and investment strategies set by the Board. It is essentially the starting point and most important component for CalPERS to achieve successful returns on investments. In the long run, it is the way we diversify stocks, bonds, cash, and other investments that is largely responsible for our returns.

The Board reduced our allocation to cash, international equity, and domestic equity in favor of real estate and alternative investments, citing increased expected returns.

In addition to the asset allocation policy, the following investment objectives were established for the portfolio. Investment policies are formally reviewed through the Board’s Investment Policy Subcommittee and receive final approval by the Investment Committee.



CalPERS NEW ASSET ALLOCATION		
Asset Class	Previous Policy	New Policy
Cash	1 %	—%
U.S. Fixed Income	24	24
International Fixed Income	4	4
U.S. Equity	41	39
International Equity	20	19
Alternative Investments	4	6
Real Estate	6	8
Total	100 %	100 %

Inflation

Achieve a total portfolio return of 4 percent in excess of the U.S. Consumer Price Index.

Actuarial

Achieve a total portfolio return above the assumed actuarial interest rate, currently 8.25 percent for the period July 1, 1999 through June 30, 2000.

Performance

1. For the internal equity index portfolio, achieve a return equal to the Wilshire 2500 Index, plus or minus 50 basis points.
2. For externally-managed assets, meet specific performance objectives related to their investment style, which are outlined in each contract.
3. For internal domestic fixed-income instruments, achieve a return in excess of the Salomon Brothers Large Pension Fund Index.
4. For equity real estate, achieve at least a 5 percent real rate of return.
5. For alternative and private equity investments, achieve an annual hurdle rate of 15 percent.

Alternative Investment Management (AIM) Program

The fiscal year marked several milestones for the CalPERS private equity program as we continued to develop a reputation as a leader and innovator in the private equity market. While still young, the AIM Program outperformed its benchmark, earning a 57.8 percent return on investments. Three key factors contributed to the portfolio's success:

- establishing new investment relationships with top investors in the market;
- developing innovative investment vehicles that capitalize on market opportunities; and
- enhancing our investment capability by ensuring that CalPERS is the "Investor of Choice" in the market.

Early in the year, CalPERS targeted direct private equity investments alongside large, sophisticated corporate partners and management teams.

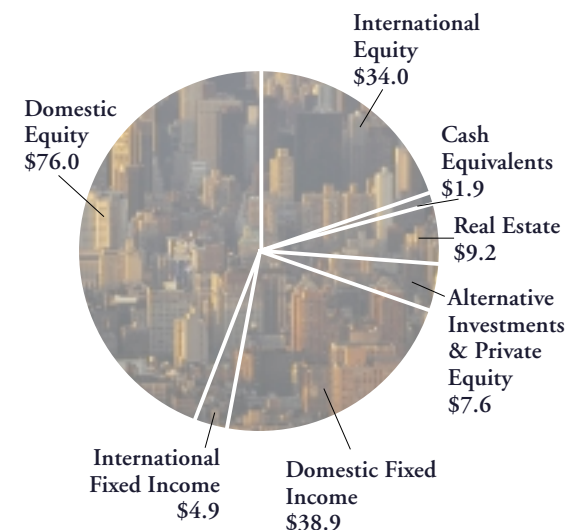
We formed a long-term strategic partnership with San Francisco-based Thomas Weisel Partners to make investments in the growing Internet, technology, and communication industries of the U.S. economy. We committed \$500 million to act as the lead investor in new funds established by the California investment bank, earmarked an additional \$500 million for future business activity of the firm, and purchased a 10 percent stake in the firm for \$100 million. This was a unique opportunity for CalPERS. Thomas Weisel Partners is one of the last major independent banks focused on some of the fastest-growing Internet, technology, and communication sectors of the economy, giving the firm a competitive advantage in the marketplace. This experience and position helped to break new ground in the growth sector, capturing value for both partners.

The development of new innovative investment vehicles also served as a primary focus of the AIM Program. More than \$1.5 billion was committed to the establishment of three investment vehicles that tapped California's economy and leading industries.

We created a CalPERS California Biotechnology Fund, a \$500 million program that capitalizes on the advent and convergence of new technologies in the California biotechnology industry, including genomics, bioinformatics, and therapeutic agents. Under the new program, CalPERS invests in existing biotechnology funds or creates strategic partnerships with pharmaceutical companies, leading universities, and public and private labs to incubate new businesses emerging from research and development.

Our second vehicle was the development of a \$500 million California Initiative Fund that targets small businesses and emerging or developing companies in underserved urban and rural California communities. We believe the

GROWTH OF INVESTMENT
PORTFOLIO — MARKET VALUE
As of June 30, 2000 - \$172.5 Billion
(Dollars in Billions)



absence of capital in these areas provides tremendous opportunity for CalPERS. Investments are regionally focused to capitalize on California’s expected growth rate of approximately six million new residents and two million new households, 70 percent of which is expected to occur in urban areas surrounding Los Angeles, San Francisco, and San Diego.

Our ability to place large amounts of long-term capital with leading-sector companies in high-growth industries spurred the creation of a third vehicle—the CalPERS Corporate Partner Program. This program offers us the ability to proactively seek bright corporate minds with industry vision and experience that will enable us to participate in the best investment opportunities.

The investment activity in the AIM program was assisted by the implementation of key recommendations by McKinsey & Company in April 2000. The Board directed McKinsey to focus on refining our strategic and organizational approach to the private equity class to improve long-term risk and return performance.

In general, the recommendations reflected the need to evolve the AIM Program as it continues to grow and to ensure that CalPERS becomes an “Investor of Choice.” In an environment where capital available to high-performing investment partners is plentiful, gaining access required CalPERS to *increase* our attractiveness as an investor. CalPERS addressed two key issues to achieve this goal—strengthening our relationship with our investment partners and streamlining the investment process.

A CLOSER LOOK AT AIM
Investments & Commitments
(Dollars in Billions)

Program Types	Number of Investments	Total \$ Investment
Partnership Program	140	\$11.2
Co-Investments	12	0.3
Direct Investments	3	1.0
Investment Vehicles	7	3.5
Total	162	\$16.0

Real Estate

California investments became one of the main focuses of our real estate portfolio during the year. We established a \$200 million Northern California Urban Infill Program that capitalizes on investment opportunities that meet the growing demands of urban communities. Under the Program, we utilize or upgrade infrastructure, reduce automobile reliance by promoting “walkable” cities and neighborhoods, encourage redevelopment before building on new land, and help reduce suburban sprawl. The redevelopment potential in California’s urban areas offers us the opportunity to reap financial gains, while also strengthening communities.

Commercial real estate and senior housing also topped our agenda. CalPERS, in conjunction with our office real estate advisor, Hines, broke ground on a 31-story, \$200 million high rise in San Francisco’s South of Market district, which has become one of the most desirable locations for Bay Area high-tech companies. The development project is slated to contain 665,000 feet of office space and 5,000 square feet of retail space, and is expected to house as many as 2,500 employees. This marks the first CalPERS investment in a

A CLOSER LOOK AT REAL ESTATE
(Dollars in Billions)

Core Real Estate Portfolio	Market Value
Office	\$2.1
Industrial	1.5
Retail	1.4
Apartment	0.8
Total Core Real Estate	\$5.8
Specialized Real Estate Portfolio (housing, timber, California urban infill)	\$2.5
Total Real Estate	\$8.3

San Francisco office development project and the largest high-rise office building approved in the city in 15 years. In a move that will help spur the California job market, Chase Hambrecht & Quist leased the entire Mission Street building for the investment bank's new West Coast headquarters.

In February, we established a national senior housing program that will invest in independent living, assisted living, and continuing care retirement community facilities. Independent living facilities are multi-unit residential projects with supportive hospitality services, meals, housekeeping, transportation, and social programs. We also plan to invest in assisted living facilities that provide 24-hour resident services such as bathing, dressing, and eating, and will consider continuing care retirement communities that meet the changing needs of residents from independent living through skilled nursing care.

Our venture into senior housing is an excellent addition to our investment portfolios that can potentially assist our own members and retirees.

Also, we established a strategic plan to invest in agricultural land that capitalizes on the increasing demand for farmland and food. Over the next few

years, we intend to work with agricultural investment professionals to develop a portfolio that focuses on permanent crops such as orchards and vineyards that earn their value through long-term growth.

During the year we witnessed the convergence of the real estate and technology industries. We acted quickly to harness the opportunities created by this phenomenon. In November 1999, we made a \$1.4 million investment in PropertyFirst.com, an on-line real estate listing service for commercial and consumer real estate. PropertyFirst.com, headquartered in Alhambra, California, is a web site where real estate investors can view property listings and prospective tenants can look for available space. The site takes information that traditionally has been closely held by brokers and directly places it in the hands of investors, business owners, consumers, property owners, lessors, and lessees. We believe that PropertyFirst.com is at the forefront of the real estate Internet revolution and will create a more efficient market for real estate transactions that will benefit large real estate investors like CalPERS.

We encourage leasing and sales agents to use PropertyFirst.com to market our properties and have provided the company access to our seven core equity real estate advisors, who manage nearly \$6 billion in apartment, industrial, office, and retail properties.

We reconfirmed our commitment to real estate and technology by developing a \$500 million investment program that invests in companies that develop real estate technology infrastructure and services, and in real estate assets expected to benefit from providing space or services to tenants in high-growth sectors of the economy.

Our goal is to leverage our real estate portfolio and network of contacts in the venture capital industry to generate a variety of investments. The result will be real estate portfolios in technology markets such as the Silicon Valley, Boston’s Route 128, and Raleigh Durham’s Research Triangle.

Global Public Markets

It was a year of successful investment management innovation and growth in our public market investment programs. CalPERS weathered several bouts of market volatility during 1999-00. We remained steadfast in our long-term investment strategy, and kept our portfolio well-diversified to help protect the safety of our members’ pensions. Although the market volatility appeared dramatic when it occurred, we fully anticipated these moments in our asset allocation process, and to a lesser extent, looked for bargains in the market.

On the international front, we adopted a new, and more flexible, selection process for hiring external equity and fixed income money managers. Under the new process, we tapped a comprehensive database of managers compiled by our investment staff and consultant, Wilshire Associates. We developed a focus universe of managers based on both qualitative and quantitative analysis. From this universe, we targeted a group of firms that either received immediate funding from CalPERS, were placed on a reserve list, or were rejected. This process allows us to capture the most qualified money managers operating in today’s global investment industry. It also preserved our public contract competitive negotiation policies, while producing a more effective and complete selection process.

The process was used to hire seven new active international fixed income managers that have a wealth of experience in managing money in the world’s markets.

A CLOSER LOOK AT GLOBAL PUBLIC MARKETS (Dollars in Billions)		
Investments	Fixed Income	Equities
Domestic	\$39.5	\$76.2
International	5.8	34.7
Total	\$45.3	\$110.9

We also selected the first manager in our Innovative Manager Development Program that focuses on the development of new and emerging money managers. Arrowstreet Capital, L.P., based in Cambridge, Massachusetts, was chosen to manage \$100 million of our international equity. The firm’s operations also received an infusion of \$3 million by CalPERS and our partner in the Program, Progress Highcrest Advisors. With CalPERS assets and capital, Arrowstreet is expected to receive the support and assistance it needs to become a significant player in the institutional marketplace. As Arrowstreet grows and matures, we will realize profits from our equity position and the returns on our international portfolio.

Additionally, we embarked on a project to conduct live securities lending auctions on-line for our \$11.8 billion Securities Lending Program. The concept joins lenders, borrowers, and brokers in one place via the web. It allows price discovery by utilizing a two-stage bidding process and offering lendable securities in discrete lots. It captures a large centralized pool of data on securities lending performance that will be used for a comprehensive benchmarking system and promises to increase market efficiency by bringing together players from across the world, enabling institutional lenders like CalPERS to retain a larger share of the revenues associated with the lending process.

Securities lending is an investment strategy through which institutional investors lend securities in order to earn incremental income on their portfolios. Agents such as large custodian banks have historically served as go-betweens in securities lending, taking a negotiated cut from the income generated by the lending process.

It's too early to measure the full impact of our idea, but we estimate that CalPERS could earn as much as \$50 million of incremental return annually, with minimal risk, by virtue of the increased efficiency gained through auctions.

Corporate Governance

New initiatives and successes marked the 13th year of our U.S. corporate governance program. Over the years the program has evolved and changed, benefiting not only from lessons learned, but also from the advice and input offered by other investors and corporate officials who share the view that accountability adds economic value.

We have learned that meaningful change cannot be forced from without—it must be advocated from within. We have watched as members of the corporate community stepped forward and exhibited leadership in pushing their colleagues to change perceptions. In this spirit, we honored a U.S. corporation, a board of directors, a chief executive officer, and an independent director for positive and courageous contributions in corporate governance. During the proxy season, Apple Computer, the Texas Instrument's Board of Directors, Time Warner's Chairman and CEO Gerald M. Levin, and retiring General Motor's Director John G. Smale were the recipients of the CalPERS Corporate Governance Award of Courage. We honored these companies and individuals for their courage and dedication to shareowner interests and to the advancement of

good corporate governance. In each area, they represent shining examples of effective governance in Corporate America.

The New York Supreme Court approved a \$4 million settlement of a shareowner's lawsuit against the former officers and directors of W.R. Grace & Co. CalPERS, one of the largest shareowners of W.R. Grace, intervened in the lawsuit in 1996 and was later named lead plaintiff. Prior to our intervention, a settlement had been proposed that would have returned no money to the corporation. After our intervention, Grace adopted a number of corporate governance reforms, including the appointment of independent outside directors to serve on the company's audit, compensation, and nominating committees.

CalPERS also received more than \$2.8 billion for shareowners in a securities class action lawsuit against Cendant Corporation. The settlement stemmed from financial statement irregularities at CUC International, one of Cendant's predecessors, and the CMS division of Cendant. It served as a landmark victory for CalPERS, demonstrating the important role that pension funds play as lead plaintiffs in securities actions.

Our achievements were rewarded later when Ernst & Young, LLP agreed to pay CalPERS and other shareholders \$335 million to settle a securities class action lawsuit on behalf of Cendant Corporate shareholders. The settlement raised the amount paid to Cendant shareholders to more than \$3 billion.

And once again, we issued our "Focus List" of Corporate America's poorest performers. The companies included Advanced Micro Devices, Bob Evans Farms, Crown Cork and Seal, A.G. Edwards, First Union Corporation, Intergraph Corporation, Lone Star Steakhouse & Saloon,

J.C. Penny Company, Phycor, and Rite Aid. CalPERS pushed a variety of corporate governance improvements at these companies in an effort to generate better returns and long-term performance. Several companies agreed to corporate governance changes, including electing independent directors, appointing lead independent directors, and commitments to make director compensation more competitive.

California Investments

California has the largest and most diverse economy in the nation. With strengths in high-tech manufacturing and services, foreign trade, and professional services, California has positioned itself as a leader in advanced telecommunications, multimedia, biotechnology, and Internet equipment and software. California is also strong in entertainment and tourism, fashion design, and agriculture.

The State has remained the industrial powerhouse of the West, providing almost 13 percent of the U.S. Gross Domestic Product (GDP) and generating more goods and services than all of the

other western states combined. California has the largest State economy in the U.S., with an estimated GDP of \$1.165 trillion in 1999. The California economy has outperformed the nation as a whole over the last four years. Since 1995, the California GDP has been growing at an average annual rate of 4.6 percent, compared to 4.1 percent for the nation. Most of this growth has been attributed to high-tech manufacturing and services, financial services, and the resurgence of the real estate market.

It is no surprise, then, that California would be appropriately represented in our investment portfolio. CalPERS investments are a critical part of the economic fabric of California.

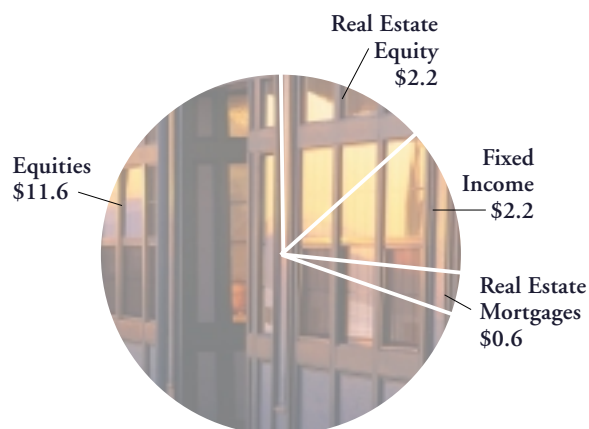
Our California investment record extends back to the early 1980's, with investments in real estate mortgages and real estate equity. They have grown steadily over the last five years. As of June 30, 2000, approximately 9 percent of our \$172.5 billion Fund was invested or committed for investment in California.

We invest nearly \$12 billion in companies based in California—from blue chip corporations on the New York Stock Exchange to start-up firms in South Central Los Angeles and the Silicon Valley. Our fixed income assets, largely held in corporate bonds, total approximately \$2.2 billion. We are one of the State's largest real estate developers, financing more than \$2.8 billion worth of single family homes and general real estate holdings. In fact, CalPERS has built more than 21,000 homes and developed 8,000 lots for single family homes. We've dedicated \$900 million to the Program and partner with seven real estate firms that work with California developers. And, since its start in 1989, the Program has provided more than \$7 billion in mortgages to nearly 54,000 California families.

CalPERS CALIFORNIA INVESTMENTS

As of June 30, 2000 - \$16.6 Billion

(Dollars in Billions)



Land—Our Most Valuable Resource

Great Palm Desert

California real estate represents nearly one-third of our total real estate assets. Our core real estate holdings help support California communities, are bringing life back to many cities' urban centers, and are supporting our State's infrastructure.

LEGISLATIVE HIGHLIGHTS

State Update

As part of its regular duties, the CalPERS Board of Administration develops legislative positions and proposals that serve the best interest of our

members and employers. The Board uses its own Legislative Policy Standards as a guide in formulating positions.

The Board supports or sponsors legislation that actively seeks to remedy inequities in benefits; corrects deficiencies in program design; adds protection to the trust; provides necessary flexibility in program administration; offers program changes developed through collaboration with

our stakeholders; provides new benefit options that support consolidation of contract options or “pooling”; or provides benefit improvements to excluded employees and retirees that recognize the unique needs of these groups and are consistent with benefits provided to represented employees.

The Board will remain neutral or take no position on legislation that changes benefits which are appropriately subject to collective bargaining; does not significantly impact benefits or System administration, or those that have conflicting policy implications; mandates changes already in our Health Program; or makes requirements to purchasers of health care.

The legislative standards also guide the Board in determining when it may be appropriate to oppose legislation. Situations of this type may include legislation that threatens the security of the Fund;

results in an unfunded liability or does not provide proper actuarial funding; deprives members of vested benefits; restricts investment authority; endangers the tax-exempt status of our programs; limits the Board’s constitutional administrative authority; creates subcategories within member classifications; threatens the integrity of the health purchasing pool; mandates benefits to the health program; or results in adverse selection between health plans.

The 1999-00 Legislative Year

The following is a brief summary of some of the CalPERS-related legislation that was enacted during the second year of the 1999-00 Session of the California Legislature. (New laws become effective January 1, 2001, unless otherwise noted.)

AB 50, Chapter 947 (Migden)

Increases the minimum death benefit for retired school members from \$600 to \$2,000 for deaths occurring on or after January 1, 2001.

AB 1009, Chapter 483 (Correa)

Guarantees that the benefit allowances paid to public agency retirees will be maintained at not less than 80 percent of their original purchasing power and modifies funding of the Purchasing Power Protection Allowance, so that each employer will fund the benefits of their retirees from their assets.

AB 1955, Chapter 961 (Migden)

Establishes the Extended Service Incentive Program as a measure intended to encourage continued service by those judges who have already served on the bench for a minimum of 20 years and who are at least 60 years old.



Agricultural Investments Feeding the World

The continued growth of the world’s population and available personal income has resulted in an increased demand for food and other agricultural products.

In May 2000, CalPERS approved a plan to invest in California agricultural land, with a specific focus on permanent crops such as orchards and vineyards that earn their value through long-term growth.

AB 2177, Chapter 1030 (Assembly Public Employees, Retirement, and Social Security Committee)

Clarifies and standardizes reporting of compensation and service of school employees, and holds school districts accountable for failure to report as required. Eliminates the Social Security offset for retirement contributions and benefit payments for school service after January 1, 2001. Clarifies that any retirement benefits available to State employees under CalPERS are within the scope of bargainable benefits for California State University employees.

AB 2383, Chapter 874 (Keeley)

Allows schools and public agencies to offer health benefits coverage under PEMHCA to less than half-time employees, as defined. Expands the definition of “annuitant” to include, under specified conditions, surviving family members of deceased retired CalSTRS members. Permits CalPERS, at the request of the CalSTRS Board, to submit a proposal to administer a health benefits program for retired CalSTRS members and their dependents.

AB 2463, Chapter 904 (Wiggins)

Permits annuitants and survivors who were eligible for, but not actually enrolled in, health benefits coverage under the CalPERS Health Program upon retirement, to enroll in the program within 60 days of retirement, or during any future Open Enrollment period.

AB 2621, Chapter 1031 (Rod Pacheco)

Provides that the final compensation upon which Special Death Benefits paid to eligible survivors are based be increased correspondingly whenever the compensation paid to active employees in the same job classifications and membership categories is increased. These increases shall cease upon the death of the surviving spouse or the date at which the deceased member would have attained age 50,

whichever is earlier. Benefit recalculations will occur annually according to a specified schedule. Also deletes the provision that children of deceased members who are eligible for the Special Death Benefit lose that eligibility upon adoption, and would restore those benefits for children whose eligibility was previously terminated.



AB 2840, Chapter 489 (Assembly Public Employees, Retirement, and Social Security Committee)

Simplifies the methods for determining the cost for various types of CalPERS service credit purchases.

SB 857, Chapter 988 (Peace)

Provides that former spouses of retired judges, whose divorce occurred after the judge retired, may elect an actuarially adjusted lifetime benefit, as currently available to former spouses in pre-retirement divorce situations. Also makes this election available to former spouses of judges who divorced and retired before the current pre-retirement divorce option became law, or are now deceased.

SB 1694, Chapter 880 (Ortiz)

Allows State CalPERS members employed by the Department of Education to participate in the election currently available to school members to retain coverage under CalPERS upon accepting employment that would otherwise be subject to coverage by CalSTRS. Contains similar provisions for CalSTRS members who accept education-related employment with the State that would be subject to coverage by CalPERS.

SB 1695, Chapter 855 (Ortiz)

Allows public agencies to provide an Alternative Death Benefit in lieu of the Basic Death Benefit to local firefighter members credited with 20 or more years of service, by contract amendment.

SB 2122, Chapter 320 (Ortiz)

Authorizes and encourages CalPERS and CalSTRS to cooperate and share information that may assist both systems in developing and implementing investment strategies, with the advice of investment experts selected by the systems. Protects confidential status of investment-related information shared between systems.



Diversity in Investment

CalPERS invests in a wide range of industries here in California and throughout the world—from blue chip stock exchange corporations to food, wine, and beverage distributors.

Federal Update

Our federal relations program continued to ensure that the interests of the System, our members, and employers were addressed in the overall federal policy-making process. During 1999-00, CalPERS was involved in initiatives covering a variety of pension and health benefit matters.

On April 7, 2000, the President signed into law a bill to eliminate the cap that reduced Social Security benefits if seniors earned more than \$17,000 per year. Under the old law, those age 65 to 69 lost \$1 of their Social Security benefits for every \$3 they earned above the income limit.

A recently enacted federal law is expected to usher in a new age of electronic commerce. The “digital signature” bill solidifies the legal status for certain contracts and disclosures made through the Internet. As public pension plans begin to introduce electronic services, this measure will allow Internet-savvy members to complete many different types of business transactions electronically with their plans, such as on-line records updates or beneficiary changes.

Legislation to improve the flexibility of pension plans is close to final passage. It would improve portability of pension assets, by allowing rollovers of retirement benefits between various types of deferred compensation and defined contribution plans (457, 403(b) and 401(k) plans and certain types of IRAs) when employees switch jobs. The bill would also allow assets from all deferred compensation and defined contribution plans to be transferred or rolled into defined benefit plans to assist employees who want to purchase service credit.

While Social Security has continued to be a top priority in Washington, D.C., and on the presidential campaign trail, support for mandatory Social Security coverage of all newly hired State and local government employees has been significantly curtailed. This success was due in large part to efforts by a coalition of public sector groups, including CalPERS.

The growing awareness of the rising costs for prescription drugs, especially for the elderly, has become a hot-button issue for Congress and the White House, although no real action is expected until the new White House and Congress are up and running. In the interim, efforts are under way to make prescription drugs reimported into the U.S. more affordable for consumers.

Support is building in Congress to improve upon the long-term care insurance tax incentives enacted in 1996. Under the latest proposals, long-term care insurance expenses could become fully deductible. This proposal would create an above-the-line tax deduction for people who purchase qualified long-term care insurance policies. In effect, people would be able to fully deduct the cost of their policy from their taxable income without itemizing.

Congress is considering several bills that would reduce the impact of the Government Pension Offset. Under current federal law, those who receive a Social Security benefit in addition to a public retirement benefit paid for by employment not covered under Social Security are subject to a reduction in their Social Security benefit. Generally, the public retirement benefit is not reduced. The law is said to hit lower income workers, mostly women, the hardest.

Congress is also considering a similar problem that occurs for some seniors who receive both a public pension and Social Security benefits. Under a federal law known as the Windfall Elimination provision, Social Security benefits are reduced for those who paid into Social Security for less than 30 years and are drawing benefits from work not covered by Social Security, such as certain government jobs. The maximum Social Security benefit reduction cannot be more than one-half the amount of the public retirement benefit.

Bankruptcy reform is another proposal that continues to be debated. For pension participants, the reform bill would expand pension protections in the event a public plan participant goes bankrupt, and would ensure that ongoing plan contributions would be allowed.

Funding Alternatives

Tomorrow's Innovations

In the late 1990's more than 1.5 percent of the State's electricity was wind generated—enough to light a city the size of San Francisco. Once thought to be experimental, the wind energy industry now provides employment for thousands of Californians. CalPERS funds high-growth industries, providing opportunity to those exploring the world of alternatives.

THE COMING YEARS

During fiscal year 2000-01, we will continue working toward the establishment of a CalPERS Customer Contact Center (CCC), which will greatly simplify the way our customers do business

with us. Instead of having to contact several *different* CalPERS divisions one by one, customers can contact the CCC, whose staff will be cross-trained to quickly fill their requests and resolve their problems. Members will be able to reach the CCC by telephone, e-mail, U.S. mail, or fax, as well as in person at our Regional Offices. The merging of our Member Services and Benefit Services Division Telephone Information Centers last fiscal year was a first step in this consolidation process.



Innovation

Most of California's recent economic growth has been attributed to high-tech manufacturing and services. As a leader in new services, California continues at the forefront of innovation.

Historically, CalPERS has been a rule-based organization, one that has been focused on process—sometimes at the expense of timely service. Our new paradigm, flexibility and nimbleness, will allow us to keep our high standards and still deliver better, friendlier customer service—while remaining competitive in a tough business environment. We want CalPERS to be a place where members can take care of most business with just one call, deal with one agent, and be confident that they are getting the information they need.

In the investment area, we will enhance investment opportunities, and improve investment administration, better managing our risk, maximizing global opportunities, and expanding our capability in the alternative investment area.

Once increased computer system security is in place, CalPERS can roll out a variety of member self-service applications to our web site, including an enhanced Retirement Planning Calculator that uses actual annual member statement data, as well as on-line member address changes and workshop and seminar registrations. We expect over the next five years to expand tremendously our members' ability to conduct business over the Internet. At the same time, we are working on an electronic investment trading system, links to partner-provided services, and even video communications on the web.

Our focus continues to be on serving our members, and we will continue to rely on our resources, both human and technological, to ensure that we do so in the most expeditious and efficient manner possible.



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